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SUMMARY OF CASES

RELATING TO

FARMERS' COOPERATIVE ASSOCIATIONS

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Prepared by

Lyman S. Hulbert

Liaison-Cooperative Attorney
Office of the Solicitor
Washington, D.C.

For the

COOPERATIVE RESEARCH AND SERVICE DIVISION

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Officers As Employees - Social Security Taxes

26 U.S.C. 1410 et seq. requires the payment of employment taxes by "every employer" with respect to individuals in his employ regardless of the number of such individuals. 26 U.S.C. 1600 et seq. requires the payment of employment taxes by employers of eight or more employees. Each of these taxes is in addition to the other. In regard to each of these taxes the question arises of whether officers of corporations who are not regularly employed by them are employees within the meaning of the law so that corporations must pay taxes on account of such officers, and whether such officers are to be counted as employees in determining if a corporation has eight or more employees. With respect to each tax the law provides that "The term 'employee' includes an officer of a corporation." See 26 U.S.C. 1426(d) and 26 U.S.C. 1607(i). Regulations 106 issued by the Bureau of Internal Revenue give considerable information regarding the first tax and beginning on page 1[illegible] of those regulations it is said:

> "An officer of a corporation is an employee of the corporation but a director as such is not. A director may be an employee of the corporation, however, if he performs services for the corporation other than those required by attendance at and participation in meetings of the board of directors."

Regulations 107 issued by the Bureau of Internal Revenue give considerable information regarding the second tax and on page 16 thereof there is a statement identical with that quoted above.

It is understood that the Bureau of Internal Revenue proceeds upon the theory that an officer of a corporation is an employee even though he receives no compensation for his services and even though he is not regularly employed. A number of cases have been passed upon by the courts involving the question of whether an officer who receives no compensation and who is not actually employed by the corporation is to be regarded as an employee for the purpose of determining if the corporation has eight or more employees.

There is quite a division among the courts that have passed upon this question. In the case of Nicholas v. Richlow Mfg. Co., 126 F. 2d 16, the court held that an officer not regularly employed and not receiving any compensation was an employee for the purpose of determining if the corporation was an employer of eight or more persons. Apparently the court was of the opinion that the statutory provision that an officer of a corporation was an employee was mandatory. A like conclusion was reached in the case of Beaverdale Memorial Park v. United States, 47 F. Supp. 663, and in Builders Lumber & Supply Co. v. United States, 48 F. Supp. 241.

In the case of Deecy Products Co. v. Welch, 124 F 2d 592, 139 A.L.R. 916, the Circuit Court of Appeals for the First Circuit held that such officers were not employees, and a similar holding was made by the Fifth Circuit Court of Appeals in the case of Independent Petroleum Corp. v.

Fly, 141 F 2d 189, 152 A.L.R. 928. See also Magruder v. Yellow Cab Co. of D. C., 141 F 2d 324, 152 A.L.R. 516, decided by the Fourth Circuit Court of Appeals. Again in the case of United States v. Aberdeen Aerie No. 24, 148 F 2d 655, the officers of the fraternal organization were ritualistic officers, and the Circuit Court of Appeals for the Ninth Circuit held that they were not to be regarded as employees from the standpoint of determining if the fraternal organization had eight or more employees, and also were not to be regarded as employees from the standpoint of taxes payable by employers under 26 U.S.C. 1400 et seq. In this connection the court said in part:

> "The compensation received by each of these officers (in no case more than $1.00 per month, and in some instances as low as 33 1/3 cents) was purely nominal and in no way commensurate with the services performed. The District Judge committed no reversible error in classifying this recompense as mere honorariums and not salaries subject to this tax. It is clear that Congress did not intend to protect this type of service, obviously not engaged in for the purpose of procuring a livelihood, by the unemployment compensation provisions of the Act.
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> "There is considerable discussion by both appellant and appellees with respect to whether Section 1101(a)(6) of Title XI of the Social Security Act, 42 U.S.C.A. § 1301(a)(6), applicable to both Titles VIII and IX of that Act, and Sections 1426(d) and 1607(i) of the Internal Revenue Code should be construed to mean that an officer of a corporation is an employee per se. While that question is not properly before this Court, for the District Court made no such finding, we are inclined to agree with the considered weight of authority that each officer must meet the accepted tests of employer-employee relationship to come within the scope of the Act."

In the case of National Mocden Box Association v. United States, 59 F. Supp. 118, the Court of Claims of the United States held that officers of the plaintiff corporation who received no compensation were not to be considered as employees in determining if the plaintiff had eight or more employees, and held that the corporation was entitled to recover $1081.93 less 60 cents which had been refunded, plus interest as allowed by law on account of taxes which had been collected on account of certain officers. In holding that the plaintiff was entitled to recover, the court said in part:

> "It would seem, therefore, that Congress used the word 'employ' in its usual sense of 'to hire,' and that the tax was levied only on those who hired eight or more persons. Since the tax was to be measured by the wages paid for the employment, the presumption is that Congress, in levying the tax on one having eight or more employees, had in mind only paid employees. An officer who received no compensation did not increase the tax burden on a corporation subject to the tax, for the tax was measured by the total wages paid.

Since in measuring the tax such a person did not count, it would seem inconsistent to count him in order to bring the corporation within the class subjected to the tax. For both purposes it would seem Congress had in mind only persons who were paid compensation.

"This is the usual sense in which the word 'employee' is used. Webster defines an employee as 'one who works for wages or salary in the service of an employer.' It is generally so defined. In fact, there can be no enforceable contract of employment without an agreement to pay compensation in some form; otherwise, there would be no consideration for the contract.

"The Act uses the word 'wages' instead of compensation. It defines this word to mean 'all remuneration for employment, including the cash value of all remuneration paid in any medium other than cash.' Unless these officers received some sort of remuneration having a cash value, they were not employees as that word was evidently used in the Act. It is agreed that they received no compensation having a cash value."

Inasmuch as agricultural cooperative associations exempt from the payment of Federal income taxes under 26 U.S.C 101 are exempt with respect to each of the unemployment taxes referred to above on any employees if the remuneration for the services performed by such employees in a calendar quarter does not exceed $45 (26 U.S.C. 1426(b)(10)(A); 26 U.S.C. 1607 (b)(10)(A)), it follows entirely independent of the question of whether an officer of such an agricultural cooperative association who is not regularly employed as an employee of the association is an employee, that like any other employee, if he receives no compensation or compensation in any quarter in an amount that does not exceed $45, that no taxes would be required to be paid on his account and that any such employee whether an officer or not could be excluded by an exempt agricultural cooperative association in determining if the association had eight or more employees. In Regulations 107 issued by the Bureau of Internal Revenue on page 35 it is said:

"Since the remuneration for the services performed by A during such quarter does not exceed $45, all of such services are excepted. Thus, A is not counted as an employee in employment on any of the days during such quarter for purposes of determining whether the X organization is an employer (see section 403.205)."

Associated Press et al. v. United States

On June 18, 1945, the Supreme Court of the United States in Associated Press et al. v. United States, 89 Law Ed. 1512, affirmed the judgment of the Federal District Court holding, among other things, that bylaws of the Associated Press were contrary to the Sherman Anti-Trust Act.

The Associated Press is a cooperative association of publishers of newspapers. In the opinion of the Supreme Court it was said:

"The publishers of more than 1200 newspapers are members of the Associated Press (AP), a cooperative association incorporated under the Membership Corporation Law of the State of New York. Its business is the collection, assembly and distribution of news. The news it distributes is originally obtained by direct employees of the Association, employees of the member newspapers, and the employees of foreign independent news agencies with which AP has contractual relations, such as the Canadian Press. Distribution of the news is made through interstate channels of communication to the various newspaper members of the Association, who pay for it under an assessment plan which contemplates no profit to AP."

The United States filed a suit against the Associated Press and other defendants seeking an injunction charging that they had violated the Sherman Anti-Trust Act in that "their acts and conduct constituted (1) a combination and conspiracy in restraint of trade and commerce in news among the states, and (2) an attempt to monopolize a part of that trade." The court said:

"The heart of the government's charge was that appellants had by concerted action set up a system of By-Laws which prohibited all AP members from selling news to non-members, and which granted each member powers to block its non-member competitors from membership. These By-Laws, to which all AP members had assented, were, in the contest of the admitted facts, charged to be in voilation of the Sherman Act. A further charge related to a contract between AP and Canadian Press, (a news agency of Canada, similar to AP) under which the Canadian agency and AP obligated themselves to furnish news exclusively to each other. The District Court, composed of three judges, held that the By-Laws unlawfully restricted admission to AP membership, and violated the Sherman Act insofar as the By-Laws' provisions clothed a member with powers to impose or dispense with conditions upon the admission of his business competitor. Continued observance of these By-Laws was enjoined. The court further held that the Canadian contract was an integral part of the restrictive membership conditions, and enjoined its observance pending abandonment of the membership restrictions. The government's motion for summary judgment, under Rule 56 of the Rules of Civil Procedure, was granted and its prayer for relief was granted in part and denied in part. 52 F. Supp. 362. Both sides have brought the case to us on direct appeal. 15 U.S.C., Sec. 29; 28 U.S.C., Sec. 345."

As indicated by the foregoing quotation the Federal District Court held that bylaws imposing restrictions on applicants for membership in the Associated Press, in the light of admitted facts, constituted per se a violation of the Sherman Act, and therefore the Court enjoined the defendants from observing the bylaws. Judgment was rendered against the defendants without going to trial and the defendants argued that this was error; but the Supreme Court held that "the restrictive arrangements which appellants admitted, were sufficient to justify summary action by the court at that stage of the case."

The scope and character of the bylaws which were under attack are revealed in the following quotations from the opinion of the Supreme Court:

"These By-Laws, for a violation of which members may be thus fined, suspended, or expelled, require that each newspaper member publish the AP news regularly in whole or in part, and that each shall 'promptly furnish to the corporation, through its agents or employees, all the news of such member's district, the area of which shall be determined by the Board of Directors.' All members are prohibited from selling or furnishing their spontaneous news to any agency or publisher except to AP. Other By-Laws require each newspaper member to 'conduct his or its business in such manner that the news furnished by the corporations' shall not be made available to any non-member in advance of publication. The joint effect of these By-Laws is to block all newspaper non-members from any opportunity to buy news from AP or any of its publisher members. Admission to membership in AP thereby becomes a prerequisite to obtaining AP news or buying news from any one of its more than twelve hundred publishers. The erection of obstacles to the acquisition of membership consequently can make it difficult, if not impossible for non-members to get any of the news furnished by AP or any of the individual members of this combination of American newspaper publishers.

"The By-Laws provide a very simple and on-burdensome road for admission of a non-competing applicant. The Board of Directors in such case can elect the applicant without payment of money or the imposition of any other onerous terms. In striking contrast are the By-Laws which govern admission of new members who do compete. Historically, as well as presently, applicants who would offer competition to old members have a hard road to travel. This appears from the following facts found by the District Court.

"AP originally functioned as an Illinois corporation, and at that time an existing member of the Association had an absolute veto power over the applications of a publisher who was or would be in competition with the old member. The Supreme Court of Illinois held that AP, thus operated, was in restraint of trade. Inter-Ocean Publishing Co. v. Associated Press, 184 Ill. 438. As a result of this decision, the present Association was organized in New York. Under the new By-Laws, the unqualified veto power of the Illinois AP members was changed into a 'right of protest' which, when exercised, prevented the AP directors from electing the applicants as in other cases. The old member's protest against his competitor's application could then be overruled only by the affirmative vote of four-fifths of all the members of AP.

"In 1931, the By-Laws were amended so as to extend the right of protest to all who had been members for more than 5 years and upon whom no right of protest had been conferred by the 1900 by-laws. In 1942, after complaints to the Department of Justice had brought about an investigation, the By-Laws were again amended. These

By-Laws, presently involved, leave the Board of Directors free to elect new members unless the appellants [applicants] would compete with old members, and in that event the Board cannot act at all in the absence of consent by the applicant's member competitor. Should the old member object to admission of his competitor, the application must be referred to a regular or special meeting of the Association. As a prerequisite to election, he must (a) pay to the Association 10% of the total amount of the regular assessments received by it from old members in the same competitive field during the entire period from October 1, 1900 to the first day of the month preceding the date of the election of the applicant, (b) relinquish any exclusive rights the applicant may have to any news or news picture services and when requested to do so by his member competitor in that field, must 'require the said news or news picture services, or any of them, to be furnished to such member or members, upon the same terms as they are made available to the applicant', and (c) receive a majority vote of the regular members who vote in person or by proxy. These obstacles to membership, and to the purchase of AP news, only existed where there was a competing old member in the same field.

"The District Court found that the By-Laws in and of themselves were contracts in restraint of commerce in that they contained provisions designed to stifle competition in the newspaper publishing field. The court also found that AP's restrictive By-Laws had hindered and impeded the growth of competing newspapers. This latter finding, as to the past effect of the restrictions, is challenged. We are inclined to think that it is supported by undisputed evidence, but we do not stop to labor the point. For the court below found, and we think correctly, that the By-Laws on their face, and without regard to their past effect, constitute restraints of trade. Combinations are no less unlawful because they have not as yet resulted in restraint. An agreement or combination to follow a course of conduct which will necessarily restrain or monopolize a part of trade or commerce may violate the Sherman Act, whether it be 'wholly nascent or abortive on the one hand or successful on the other.' For these reasons the argument, repeated here in various forms, that AP had not yet achieved a complete monopoly is wholly irrelevant. Undisputed evidence did show, however, that its By-Laws had tied the hands of all of its numerous publishers, to the extent that they could not and did not sell any part of their news so that it could reach any of their non-member competitors. In this respect the Court did find, and that finding cannot possibly be challenged, that AP's By-Laws had hindered and restrained the sale of interstate news to non-members who competed with members."

It was apparently argued that inasmuch as the Associated Press was a cooperative enterprise that this gave it some special status or standing relative to the anti-trust laws. In denying the validity of this contention the Court said:

"It is significant that when Congress has desired to permit cooperatives to interfere with the competitive system of business, it has done so expressly by legislation."

In support of this statement the following footnote was given:

"See e.g., 7 U.S.C. 291, 292, as to farm cooperatives; 15 U.S.C. 17, as to labor organizations. But see also as to the latter, Apex Hosiery Co. v. Leader, 310 U.S. 469, 487-498."

This furnishes an additional basis for the view that the Supreme Court of the United States regards the Capper-Volstead Act as valid. In fact it is believed to be a fair statement that this was assumed in the case of United States v. Borden Company, 308 U.S. 188, Summary No. 5, page 1.

It is questioned if the foregoing quotation was intended to have the connotation which it carries on its face because in the Borden case just cited the Supreme Court held that the Capper-Volstead Act did not give the milk cooperative association involved in that case any right "to interfere with the competitive system of business." In fact the milk cooperative was specifically held to be amenable to the anti-trust laws. Farmers, by the Capper-Volstead Act, are authorized to form associations that meet its conditions. And such associations undoubtedly do reduce the competition among farmers in the sale and marketing of their products; but such an association when organized is as subject to the anti-trust laws as are other business corporations. In its relations with third persons its rights are no greater than those of other corporations.

The Associated Press did not have a monopoly on news, because anyone was free to report any occurrence or event that he might desire to report. The bylaws of the Associated Press imposed restrictions on the admission to membership of publishers of papers that were in competition with old members and restricted individual newspapers from furnishing news to nonmember newspapers, but anyone was free on his own initiative to arrange to have reported any item of news on which he desired a statement.

Some question has been raised regarding whether the decision of the Supreme Court in this case announces restrictions applicable to the right of agricultural cooperative associations to do things which they have customarily been engaged in doing. It is believed that the Capper-Volstead Act does not operate to give agricultural cooperative associations meeting its conditions a right to engage in acts or practices after their organization, that could not be engaged in by other business entitles. It is quite generally accepted that the object and purpose of the Capper-Volstead Act was to authorize farmers to form cooperative associations, but that such associations when organized may not engage in acts or practices which would be a violation of the anti-trust laws if performed by anyone else. If a cooperative organization that does not meet the conditions of the Capper-Volstead Act may not restrict its membership, may a Capper-Volstead association do so? That Act does not specifically confer the right on an association that meets its conditions to restrict membership.

It has quite generally, however, been believed that cooperative associations have the right to choose and select their members. (See McKane v. Adams as President of the Democratic General Committee of Kings Co., 123 N.Y. 609, 25 N.E. 1057; Connelly v. Masonic Mutual Benefit Ass'n, 58 Conn. 552, 20 A. 671, 9 L.R.A. 428; State v. Sibley, 25 Minn. 387; LaSalle County Farm Bureau v. Thompson, 245 Ill. App. 413; W. G. Press & Co. v. Fahy, 313 Ill. 262, 145 N.E. 103; 6 R.C.L., par. 371; 25 R.C.L. 54; Blein v. Rand, 77 Minn. 110,79 N.W. 606.)

Likewise the Supreme Court of the United States has held that one engaged in a private business is free to select his customers (Federal Trade Commission v. Raymond Brothers-Clark Co., 263 U.E. 565).

It is of course possible to argue that the decision of the Supreme Court in the Associated Press case would mean that a cooperative association could not, at least under certain circumstances, under the Capper-Volstead Act include in its organization papers provisions which were calculated to enable the association to restrict its membership. The principle that the Capper-Volstead Act does not give agricultural cooperative associations meeting its conditions any rights or privileges not possessed by other comparable entities would seem to strengthen this argument. By analogy of course it could be contended that the refusal of a marketing cooperative association to admit a person to membership operated to deny him a market for his agricultural commodities that he otherwise would have, just as the inability of persons to obtain membership in the Associated Press operated to cause them to be ineligible to obtain Associated Press news.

The analogy between the Associated Press and a large agricultural cooperative association is in many respects far from close. If a cooperative association was receiving from its members all of the commodities which it needed for meeting the requirements of its business it is difficult to believe that a court would hold that additional members must be admitted and additional commodities received for which the association did not have a market. No parallel situation could exist relative to the Associated Press.

There was a vigorous dissenting opinion by Justice Roberts, and one by Justice Murphy. Justice Roberts pointed out that other news gathering agencies similar to the Associated Press have flourished during the last few years and that some newspapers prefer the facilities of these independent news gathering agencies to those of the Associated Press. Justice Murphy significantly stated that -

> "A cooperative organization, untinged with any monopolistic or other objectionable hue, is free to exceed its competitors in size and excellence without losing its right to choose its members and to protect its own unique products from the use of others."

Cooperative Association Held Not To Be Employee of Member

The Supreme Court of California in the case of Irvine Company v. McColgan, 157 P. 2d 847, reversed the Court of Appeals of California, 145 P. 2d 325, which had held that the Irvine Company, a corporation engaged in farming, was entitled to recover a portion of the State franchise tax which it had paid on the ground that the tax it had paid covered transactions occurring in States other than in California. See Summary No. 21, page 19.

The California bank and corporation franchise tax imposed a tax upon corporations doing business in California that was measured by the net income of the corporation "for the privilege of exercising their corporate franchises within the state". The statute specifically provided that "if the entire business of such *** corporation is not done within this State, the tax shall be according to or measured by that portion thereof which is derived from business done within this State." In other words, the amount of the tax to be paid by the corporation was to be determined by the amount of business which that corporation had done within the State of California.

The Supreme Court of California said:

> "The primary question on this appeal by defendant is whether within the meaning of section 10 of the act plaintiff was doing business outside of California as well as in California so as to be entitled to have its franchise tax measured by only a portion of its net income. Defendant contends that since plaintiff had no place of business, property, or regular employees outside this state, raised its produce and prepared the same for market entirely within this state, and here received the proceeds from extrastate and interstate sales, it carried on its corporate activities and was 'doing business' only in California. He argues that sales in other states were made by purchasers of plaintiff's produce or by independent contractors, and that interstate sales transactions are to be regarded as business done in this state. On the other hand, plaintiff contends that its products were marketed outside the state in such a manner as to constitute the transaction of business by it outside of California. It argues that extrastate sales transactions or activities were carried on by plaintiff through its authorized agents, that the consummation of interstate sales entitled it to allocation, and that a tax on its entire net income would be void under the commerce and due process clauses of the United States Constitution, art. 1, § 8, cl. 3, and amend. 14, to the extent that proceeds from interstate sales entered into the measure thereof."

A large part of the agricultural products of the plaintiff corporation were marketed through cooperative marketing associations of which the plaintiff was a member, and apparently one of the principal questions for decision was whether the cooperative marketing associations were actually its "employees."

In other words it was argued that the plaintiff corporation was doing business in States other than California because cooperative associations of which the plaintiff corporation was a member were doing so. It of course was admitted that if the plaintiff corporation had had salaried employees in other States through which its agricultural commodities had been marketed, that the proceeds of such sales could have been excluded in determining the amount of the tax that the plaintiff corporation was required to pay in California. The agricultural commodities of the plaintiff corporation were marketed to a restricted extent in California "but the greater portion thereof was marketed outside of the state in the following manner:" --

> "Citrus fruits, avocados and walnuts were sold by plaintiff under marketing agreements with various local nonprofit cooperative marketing associations of which plaintiff was a member or stockholder. Pursuant to those agreements, plaintiff delivered the fruit to local associations which cleaned, graded, packed and shipped the same to marketing centers or points outside the state. Citrus fruit was shipped from the associations' packing houses in California to other states or foreign countries where it was sold from railroad or steamship terminals through the facilities of the California Fruit Growers Exchange, a cooperative with which the local associations were affiliated and which acted as the latters' sales agency. The fruit was shipped under negotiable bills of lading, consigned to the exchange or to independent produce brokers who were engaged by the exchange to sell fruit on a commission basis. Sales at public auction and private sales were conducted by such brokers or by employees of the exchange. Subject to a minimum asking price specified by the shipper and the right of withdrawal reserved by the exchange, the prices and quantities of fruit sold were determined at the time and place of sale by the brokers or employees without prior confirmation from plaintiff or the associations. Proceeds from such sales were collected by the brokers or employees, who, after deducting freight, storage, sales, insurance, taxes and other expenses, including brokerage fees or commissions, transmitted the balance to the exchange. Thereafter in the ordinary course of business plaintiff received from the local associations its pro rata share of the proceeds less its pro rata share of expenses. Walnuts were handled in a somewhat similar manner, being consigned to the California Walnut Growers Association, stored in warehouses in its name, and later withdrawn and sold exclusively at private sales by independent brokers engaged by it on a commission basis. Avocados were marketed in a slightly different manner in that after arrival at their destination they were stored in warehouses in the name of the local association and thereafter withdrawn and sold by it at private sales.
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> "The bulk of plaintiff's bean crop was prepared for market and shipped by plaintiff to out-of-state destinations where it was stored in warehouses or at railroad and steamship terminals and thereafter sold by brokers on a commission basis. Such produce was consigned to plaintiff on negotiable bills of lading or to independent produce brokers. Subject to a minimum asking price specified from time to time by the shipper, sales were made at prices and in quantities

determined by the brokers without prior confirmation from plaintiff. The brokers collected the proceeds and, after deducting freight, storage, sales, insurance, taxes and other expenses, including their commissions, transmitted the balance to plaintiff in California.

"A portion of plaintiff's bean crop and other vegetables were prepared for market and shipped by plaintiff to points outside California consigned to purchasers on bills of lading with sight drafts attached. Proceeds from such sales were forwarded to plaintiff by collecting banks."

The Supreme Court of California held that none of the sales which were made outside of that State by cooperative associations, by brokers, or otherwise constituted doing business by the plaintiff corporation outside of California, and therefore held that all of the business of the plaintiff corporation was done in California. In reaching this conclusion the court said in part:

"Transactions engaged in for a foreign corporation in a state are not necessarily engaged in by the corporation in that state. As stated in Union Internationale De Placements v. Hoey, 2 Cir., 96 F.2d 591, 592, 'business transactions within the taxing jurisdiction for the account of a foreign corporation do not necessarily involve the doing of business within the jurisdiction.' Thus, although factors or commission merchants are agents, it has been held that their activities in a state do not constitute the doing of business therein by the foreign principals they represent within the purview of statutes imposing franchise or license taxes. People v. Roberts, 25 App. Div. 13, 48 N.Y.S. 1028; City of Atlanta v. York Mfg. Co., 155 Ga. 33, 116 S.E. 195; cf. People v. Gilchrist, 244 N.Y. 114, 155 N.E. 68; 61 C.J. 339. Support for this position is found in the analogy afforded by decisions to the effect that foreign corporations are not doing business so as to be subject to the qualification laws of, or amenable to process in, states to which their products have been consigned for sale and sold by factors or commission merchants. Bartling Tire Co. v. Coxe, 5 Cir., 288 F. 314; Mitchell Wagon Co. v. Poole, 6 Cir., 235 F. 817, 149 C.C.A. 129; Butler Bros. Shoe Co. v. United States Rubber Co., 8 Cir., 156 F. 1, 84 C.C.A. 167; Republic Steel Corp. v. Atlas Housewrecking & Lumber Corp., 232 Mo. App. 791, 113 S.W. 2d 155; 17 Fletcher, Cyclopedia Corporations, 520; see Cannon Mfg. Co. v. Cudahy Pkg. Co., 267 U.S. 333, 336, 45 S. Ct. 250, 69 L. Ed. 634; cf. Bank of America v. Whitney Central Nat. Bank, 261 U.S. 171, 43 S. Ct. 311, 67 L. Ed. 594. The decisions reason that since factors or commission merchants are independent contractors, the disposition of goods in their possession in accordance with the directions of their foreign principals constitutes a part of their business rather than the business of the individuals or corporations whose products they sell. People v. Roberts, supra, 25 App. Div. 13, 48 N.Y.S. at page 1029; 23 Am. Jur. 308. In other words, jurisdiction of foreign corporations for purposes of process and regulation, as well as taxation, is dependent upon their presence or the exercise of their corporate franchises, and the sale of products of such corporations by independent contractors does not involve corporate

presence or the exercise of corporate franchises. Cf. Union Internationale De Placements v. Hoey, supra.

"It would seem to follow that if a foreign corporation marketing its products in a state through factors is not thereby 'doing business' in that state, it is not thereby 'doing business' outside of the state in which it engages in production activities. Cf. Watson, Allocation of Business Income for State Income Tax Purposes, 25 Minn. L. Rev. 851, 894, n. 179.

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"We conclude that a corporation transacting business in this state is entitled to an allocation of income for franchise tax purposes only when business is done outside of the state by the corporation acting through its officers or agents, that a cooperative marketing association is not such an agent of its grower members that the latter can be said to be doing business where sales by the former take place, and that, therefore, plaintiff was not entitled to allocation merely because its products were sold in other states by cooperative marketing associations. In addition, it might be noted that with the exception of avocado sales, the activities of the local cooperatives were confined to California; that the vast majority of sales were arranged and conducted by the California Fruit Growers Exchange and the California Walnut Growers Association under marketing agreements with the local cooperatives; and that at least some of the extrastate sales were made by independent produce brokers employed by the exchange and the association.

"With respect to the marketing of plaintiff's bean crop by independent produce brokers, the parties are again in disagreement as to the effect of extrastate sales. While plaintiff insists that the making of such sales constituted the doing of business by it outside of this state, defendant urges a contrary conclusion on the ground that the brokers were independent contractors.

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"We are of the opinion, therefore, that a corporation transacting business in this state is not doing business outside of the state within the meaning of section 10 of the Bank and Corporation Franchise Tax Act, by virtue of the fact that its products are sold from warehouses in other states by independent brokers. See Watson, Allocation of Business Income For State Income Tax Purposes, 25 Minn. L. Rev. 851, 877, 893. And we think it is worthy of note that since at least 1934, section 10 has been construed in conformity with this view by the administrative officials charged with its enforcement, and that it has been twice reenacted or amended since 1934. Appeal of Great Western Electro Chemical Co., Cal. C.C.H. Tax Service, par. 5-802.3." (Underscoring added.)

As previously pointed out, this case holds that even though the relation between a cooperative marketing association and one of its members is that

of agency, that a member of a cooperative is not doing business outside of the State of California simply because the cooperative association of which it is a member is engaged in doing business outside of that State.

As pointed out in the opinion, the handling of commodities for a foreign corporation by factors or commission merchants does not ordinarily cause the foreign corporation to be doing business in the State in which the factors or commission merchants are located; and such factors and commission merchants operate on an agency basis.

Trade Marks — Sunsweet

In the case of California Prune & Apricot Growers Ass'n v. H. R. Nicholson Co. (Cal. App.) 158 P.2d 764, the association brought a suit charging infringement of its trade mark "Sunsweet", and unfair acts of competition.

The defendant was engaged in marketing fruit juices for making soda pop and other beverages while the association was engaged in the processing of prunes which could be used for food or for making prune juice. The court held that the products of the parties possessed the same descriptive properties so that the use by the defendant of a trade mark similar to the association's prior trade mark constituted trade mark infringement and unfair competition. It was urged by the defendant that its trade mark was sufficiently unlike the trade mark of the association that purchasers were not being deceived. In this connection the court said:

> "The distinctions made by the defendant are not sound. The correct test to be applied was stated in Sun-Maid Raisin Growers v. Mosesian, 84 Cal.App. 485, 258 P. 630. In that case, 84 Cal. App. at page 497, 258 P. at page 635, the court said: 'The authorities are fairly uniform to the effect that it is not necessary to prove actual fraud or deception, but this may be assumed where the facts indicate that a purchaser, exercising ordinary care, would be likely to be deceived by the imitation of a trade-mark.'"

Stock Purchased By Association Under Statute

In the case of Avon Gin Co. v. Bond, decided by the Supreme Court of Mississippi, 22 So. 2d 362, "The sole question presented for decision on this appeal is the construction of Section 4485, Code 1942, defining the rights of a shareholder of capital stock in an incorporated association of producers of agricultural products which has been organized under the agricultural association law of this State, when such shareholder has ceased to be eligible to hold his stock by reason of the fact that he is no longer a producer of agricultural products."

The statute of Mississippi among other things provided:

> "If any shareholder shall cease to be eligible to hold his shares, or shall die, or shall be dissolved, and if his shares be not promptly transferred to some producer or organization eligible to

hold the same, the association shall take up such shares at par value or, at the option of the association, at appraised value, such value to be conclusively fixed by the board of directors of the association, and the association may pay therefor in cash or by certificate of indebtedness to be thereafter paid from the income of the association."

The stockholder contended in the trial court that despite the language of the Mississippi statute he was entitled to be paid for his stock as "if the assets of the defendant (appellant) as of April 15, 1944, were to be divided among the existing stockholders of defendant (appellant)."

The trial court adopted this view and on account of this fact the Gin Company appealed. The association contended in the trial court, and successfully on appeal, that it had the right to take up the ten shares of stock of the stockholder for $1,000, this being the par value of the stock. The appellate court in holding in favor of the Gin Company emphasized that the stockholder knew or should have known as a matter of law at the time he became a stockholder that the association had the right under the statute to retire his stock at the par value thereof when he was no longer a producer of agricultural products.

In support of this conclusion the court called attention to the fact that the statute under which the association was incorporated provided that "upon the dissolution of the association, any assets remaining after the payment of debts and the retiring of outstanding stock at par value, shall be divided among the members, whether shareholders or not." In this regard the court said:

"Since the right is given by the statute to the non-shareholder, whose patronage at the gin helped to create its assets, to share upon its dissolution in such of the assets as remain after the payment of debts and the retiring of outstanding stock at par value, it would necessarily follow that their rights would be violated by paying to a shareholder who becomes ineligible to hold his stock more than the par value thereof."

Note Held Not An Unconditional Promise To Pay

In the case of Omaha Bank for Cooperatives v. Novotny, 17 N.W. 2d 836, decided by the Supreme Court of Iowa, the bank brought suit upon a note which was originally given to the Iowa Poultry Producers Marketing Association of Ottumwa, Iowa, and which was given as security by that association for a loan from the bank.

It was the contention of the defendant that the note was to be paid entirely out of deductions to be made from proceeds received from poultry that he might deliver to the association for marketing. The note as given by the defendant and the receipt therefor as given by the association are set forth in the following quotation from the opinion of the court:

"'50.00 Ottumwa, Iowa, Sept.8, 1936.

"For value received, on demand, I promise to pay to the order of the Iowa Poultry Producers Marketing Association Fifty Dollars at the Ottumwa Office with interest at the rate of five (5) per cent per annum from maturity upon all unpaid balances. The amounts due me and retained by the Association prior to the maturity hereof are to be applied to the payment of this note.

'Fred Novotny

"'P. O. Traer Iowa R 1'

Endorsements:

'Deducted $4.20 to 10-14-39 Bal. $45.80 C.E.C.

'Pay to the order of Omaha Bank for Cooperatives, Omaha, Nebraska.

'Demand for payment, notice of default or nonpayment, protest and notice of protest, and notice of extension, substitution or other collateral, or other indulgence, are hereby waived; and the rights of the holder shall remain undisturbed notwithstanding any extensions of time, substitution of collateral or other indulgence granted by such holder.

'Iowa Poultry Producers Marketing Association
"By H.E. Hazen, President.'

"There was attached to the original note at the time of its execution, but separated from it by a perforation line, a receipt, which is as follows:

"'$50.00 No._____

'Ottumwa, Iowa, Sept. 8, 1936.

'The Iowa Poultry Producers Marketing Association hereby certifies that it has received from Fred Novotny Traer, Iowa case in the amount of $____ and note in the amount of $50.00

'The amount not paid in cash, is to be paid by deduction, in addition to the revolving fund, of one (1) cent per pound of poultry, and one (1) cent per dozen of eggs delivered to the Association, from net returns of such poultry products so delivered to the Association.

'When the note is paid, the Association agrees to issue to Fred Novotny a Loan Certificate for the amount paid. Such Certificate shall be payable as provided in the By-Laws of the Association and shall be subject to the prior claims of all common creditors of the Association.

'Iowa Poultry Producers Marketing
Association
'By (Signed) Arnold B. Corne.'"

The court found that there was ample evidence to show that the bank had knowledge of the manner in which the Iowa Poultry Producers Marketing Association was organized and of the nature of its financial program "and of the general plan by which poultry producers were sought to be interested in giving notes similar to the one involved. . ."

Without passing upon the question of whether the note involved was a negotiable instrument, the court found that the bank was not a holder in due

course. In support of this conclusion the court quoted with approval the following:

> "It is the rule, well settled in this state, that instruments relating to the same transaction and contemporaneously executed will be construed together."

The court further said:

> "After a study of the note sued on, the receipt, and the authorities we have referred to, as well as many others, we have reached the conclusion that the note was not an unconditional promise to pay, unaffected by the provisions of any statement in the note or in the originally attached receipt.
>
> "It should be kept in mind that in the note we find the following statement: 'The amounts due me and retained by the association prior to the maturity hereof are to be applied to the payment of this note.' And in the receipt we find this significant statement: 'The amount not paid in cash, is to be paid by deduction. * * *'
>
> "The authorities previously referred to are ample basis for considering together these two instruments. Then, too, we must keep in mind that the note makes reference to the anticipated retention of certain payments due the maker and the application of these amounts to the payment of the note. This statement in the note necessarily gives rise to the conclusion that there is a further and additional agreement in existence relative to the matter of retention. When we refer to the receipt that was executed contemporaneously with the note we find ample reason for concluding that there cannot be recovery on the note sued on. There, as previously set out, it definitely states that the amount not paid in cash, is to be paid by deductions. In the instant case there was no cash paid and consequently it must be concluded that the payments were then to be made only by deductions. Therefore, when we consider these two instruments together we can reach no other conclusion than that there can be no recovery on the note."

If the bank had not known of the receipt for the note which was executed by the Iowa Poultry Producers Marketing Association and had taken the note soon after its execution it is assumed the holding of the court would have been otherwise. The note was payable on demand and therefore it would have been required that it be taken by the bank within a reasonable time after its execution in order that the bank might be a holder in due course, because a note payable on demand is due within a reasonable time after its execution. See McAdam v. Grand Forks Mercantile Co., 24 N.D. 645, 140 N.W. 725, 47 L.R.A. (N.S.) 246.

Cooperative Marketing Association Not a Farmer

In the case of Walling v. McCracken County Peach Growers Association, 50 F. Supp. 900, arising under the Fair Labor Standards Act, 29 U.S.C. 201

et seq., the court, in holding that the employees of this marketing association were not engaged in agriculture and hence were not exempt from that act, said:

> "The defendant association is a corporation; it is not a farmer; its employees are not all farmers. Its operations are not performed on a farm. Bowie v. Gonzalez, 1 Cir., 117 F. 2d 11, 18."

Cooperative Milk Association Recovers Unauthorized Assessments

In the case of Shawangunk Co-op. Dairies v. Jones, 59 F. Supp. 848, the cooperative instituted an action against Marvin Jones, as War Food Administrator, and Claude R. Wickard, as Secretary of Agriculture, to review a ruling by the Administrator denying the cooperative a refund of money which it had paid under protest under an order issued by the War Food Administrator under the Agricultural Marketing Agreements Act of 1937 (7 U.S.C. 601 et seq.).

The order established an equalization pool. It appeared that the cooperative association allowed another cooperative association which had ceased to operate a milk handling plant to have its members deliver their milk to its plant, but the association did not purchase the milk, acquire it, or test it, and simply acted as a gratuitous bailee with respect thereto.

On account of the fact that the milk in question passed through the plant of the cooperative association it was required to make a payment to the Producers' Settlement Fund in the sum of $1,783.39 and a payment for the Administrative Assessment Fund in the sum of $156.94, or a total of $1,940.33 which the association paid under protest. It was to recover this amount that the cooperative instituted the suit.

In holding in favor of the cooperative association the court said in part:

> "The plaintiff did not purchase the milk nor acquire it for marketing in any sense of the word, for the milk was purchased from the producers by Meadow Valley, bottled by Dairy Industrial Management, and sold by Meadow Valley to Vogt's Dairies, who subsequently sold it in the marketing area. The plaintiff was for the time being a gratuitous bailee of the milk which it received from the owner and bailor, Meadow Valley. The orders permissible under the Act were not intended to apply to a mere bailee. See New England Dairies v. Wickard, 2 Cir., 144 F. 2d 460. Under Order No. 27 in addition to the payment into the equalization pool, the handler was required to pay a pro rata share of the Administrator's expenses. This tends to confirm the view that Order No. 27 was intended to apply only to a proprietory handler which had acquired the milk from a producer for marketing and that it was not intended to impose liability for such expense upon a mere gratuitous temporary bailee simply because the milk passed through its receiving room but which had neither received the milk from the producer nor had any financial interest in it.

"The rulings of the Market Administrator and of the War Food Administrator appear not to be in accordance with the law, and are therefor set aside, and the matter remanded to the Administrator for proceedings in accord with this opinion."

It will be remembered that in the case of Fertile Cooperative Dairy Association v. Huston, 119 F. 2d 274, it was held that a cooperative association doing business with nonmembers as well as members, in order to be eligible for exemption from the payment of Federal income taxes must allocate on a patronage basis the amounts carried to reserves from all of its business, and "Provision must at least have been made, by appropriate enabling action on the part of the association and by adequate protective entries on its books and records, for nonmembers in such a situation as is here involved to share ratably with members, in an ultimate liquidation of the association's assets, on the basis of their comparative contributions thereto." This, of course, would operate to prevent the business done with nonmembers from increasing the book value of the outstanding stock.

Are Patronage Refunds Income to Recipient

There follows a ruling of the United States Treasury Department approved June 19, 1918, on the question of whether refunds, dividends, or rebates are to be treated as income by recipients when received from cooperative merchandising organizations:

"(T.D. 2737.)

"Income Tax.

"Cooperative merchandising organizations are subject to the provisions of the act of September 8, 1916, as amended by the act of October 3, 1917. Periodical refunds made to purchasers are to be regarded as discounts, reducing the organization's net income. The recipient need not return them as income, but should treat sums so received as rebates, reducing the cost to him of the purchases on which the refund is based.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE
Washington, D. C.

"To collectors of Internal Revenue and others concerned:

"Cooperative societies, associations, or corporations which make a periodical refund—sometimes called a dividend—to members or to prospective members or to patrons generally, in proportion to the purchases made by the recipient, are not within any of the exceptions or exemptions of the act of September 8, 1916, as amended by the act of October 3, 1917, and are subject to its provisions.

"Where such refund payments are made in accordance with by-laws or published rules regularly adhered to, they are to be regarded as discounts or rebates, tending to reduce the taxable net income of the

organization. Like discounts generally, they should appear as an added item of cost in the detailed schedule of cost items submitted with the organization's return of income.

"This ruling is in accordance with settled practice in the administration of the income-tax laws, adopted because the real purpose of such organizations is to furnish goods at cost.

"So-called 'dividends' of this character are wholly different from ordinary dividends based on stock holdings, and they need not be listed as income by the recipient. However, if the recipient is claiming the right to deduct as business expenses any expenditure on which the refund is based in whole or in part the sum claimed as a deduction must be reduced in proportion to the refund received.

DANIEL C. ROPER,
Commissioner of Internal Revenue.

"Approved June 19, 1918:
L. S. ROWE,
Acting Secretary of the Treasury."

As shown in the foregoing ruling, which it is understood has not been modified or reversed by the Treasury Department, the recipient of a rebate, patronage dividend, or refund from a cooperative merchandising organization meeting the prescribed conditions is not required to include the amount in question in computing his income taxes if the refund was based on what are commonly referred to as consumer goods, such as groceries. In such a case the refund is regarded as simply reducing the purchase price of the consumer goods.

On the other hand it is clear that a farmer receiving a patronage dividend, refund, or rebate from a cooperative marketing association based upon commodities marketed for the farmer is required to report the amount in question as a part of his income. Such a refund simply operates to increase the amount of money which a farmer receives for his commodities and obviously it must be included as taxable income in computing his income tax returns.

All commodities such as fertilizer or feed which are purchased by a farmer and which constitute a part of the cost of operating a farm are deductible in computing his income taxes. But all the patronage dividends or refunds received by a farmer on account of such purchases must be treated as reducing the cost of the fertilizer, feed or other commodity, and hence as reducing the amount that may be deducted or else such dividends or refunds must be treated as income.

Particular attention is called to the fact that the ruling of the Treasury Department is applicable only "Where such refund payments are made in accordance with by-laws or published rules regularly adhered to. . ."